United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

w/affidavit

75-6001

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-6001

B

P/S

PPG INDUSTRIES, INC.,

Plaintiff-Appellee,

—against—

THE HARTFORD FIRE INSURANCE COMPANY, NEW YORK STATE TAX COMMISSION, STATE OF NEW YORK, CAR COLOR, INC. and HENKIN & HENKIN, ESQS.,

Defendants,

AND

UNITED STATES OF AMERICA,

Defendant-Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLANT UNITED STATES OF AMERICA

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1

TABLE OF CONTENTS

TABLE OF AUTHORITIES

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Preliminary Statement

Defendant-appellant, the United States of America (the "Government"), appeals to this Court from an Opinion and Order, filed November 11, 1974, which granted the plaintiff-appellee, PPG Industries, Inc. ("PPG"), a priority in a fund belonging to the defendant-taxpayer, Car Color Inc. ("Car Color"), superior to the Government's tax liens. The Opinion and Order is reproduced in the Joint Appendix ("JA") at 101-118 and is reported at 384 F. Supp. 91 (S.D.N.Y. 1974) (Connor, *J.*).

Issues Presented

1. Does a tax lien have priority over a third-party's interest in property of a taxpayer which property came into existence after the filing of a tax lien?

2. Did the District Court err in finding that the Uniform Commercial Code provides a security interest in the proceeds of a debtor's fire insurance policy?

3. Does a tax lien have priority over a third-party's equitable lien on the proceeds of the taxpayer's fire insurance policy which proceeds came into existence after the filing of a tax lien?

Statement of the Case

A. Proceedings Below:

PPG commenced this action on June 26, 1973 in the Supreme Court of New York County to recover a $7,354.29 cash fund held by the defendant Hartford Fire Insurance Company ("Hartford") which fund was otherwise payable to Car Color. PPG and the other parties to this action, the Government, the New York State Tax Commission, and Henkin & Henkin, Esqs., had claims against Car Color in excess of the fund. The action was removed to the United States District Court for the Southern District of New York. The object of the action was to determine the priority of claims to the fund. The claim of the Government was for taxes due and owing from Car Color.

On July 25, 1974, the Honorable Harold J. Raby, United States Magistrate for the Southern District of New York, issued a report (JA at 78-98) in which he fixed the order of priority as follows: Henkin & Henkin, Esqs. received $2,654.25 for services rendered to Car Color in

creating the fund. Hartford received $500.00 for legal expenses incurred as a stakeholder. PPG received $4,200.04, the balance of the fund.* Over the objection of the Government, the order of priority was confirmed on other grounds by the District Court. The Government appeals from that portion of the District Court's Order which granted a priority to PPG superior to the Government's tax liens.

B. Facts:

This action was decided by summary judgment upon jointly stipulated facts.

Car Color operated a retail and wholesale paint store in Yonkers, New York. (JA at 129). Car Color purchased paint inventory from PPG. On September 28, 1970, Car Color and PPG entered into a security agreement. A financing statement reflecting the security agreement was filed with the Westchester County Clerk on October 8, 1970. The financing statement covered Car Color's inventory of PPG products as well as the proceeds of the inventory (JA at 63). In addition, the security agreement provided as follows:

> "5. Borrower [Car Color] will . . . (f) keep the Inventory and Equipment** insured for the benefit of Secured Party [PPG] (to whom loss shall be payable) and in such amount and with such companies and against such risks as may be satisfactory

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* The Government is the sole appellant. The distributions to Henkin & Henkin, Esqs. and Hartford do not affect the Government's claim. The distributees of the fund and the Government stipulated that the awards to Henkin & Henkin, Esqs. and Hartford could be paid out pending this appeal and the disputed portion of the fund has been deposited in the Registry of the District Court.

** The security agreement did not cover equipment (JA at 61).

> to Secured Party; pay the cost of all such insurance; and deliver certificates evidencing such insurance to Secured Party; and Borrower assigns to Secured Party all right to receive proceeds of such insurance, directs any insurer to pay all proceeds directly to Secured Party, and authorizes Secured Party to endorse any draft for such proceeds . . ." (JA at 61).

On December 10, 1970, Car Color obtained a fire insurance policy in the amount of $25,000 from Hartford (JA at 25, 57). The only named insured or loss-payee on the policy was Car Color (JA at 57). This insurance policy was not obtained by Car Color in compliance with section 5(f) of the security agreement because PPG was not named the loss-payee nor was Hartford instructed to deliver any insurance proceeds to PPG. Car Color's premises was substantially destroyed by a fire on December 23, 1971 (JA at 57). At no time did Car Color assign or attempt to assign its rights to the insurance policy to PPG, notwithstanding the extent to which an assignment was contemplated in paragraph 5(f) of the security agreement. PPG, moreover, did not attempt to compel Car Color to name it as loss-payee.

Hartford disclaimed liability under the policy claiming that the fire was caused by arson attributable to Car Color (JA at 135). On November 29, 1972, Car Color commenced an action in the Supreme Court of New York County against Hartford demanding judgment in the amount of $22,549.75 for failure to make payment to Car Color under the insurance contract.* That action was removed to the United States District Court for the Southern District of New York. The District Court found that Hartford had

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* Petition for Removal, dated January 8, 1973, *Car Color, Inc.* v. *Hartford Fire Insurance Co.*, 73 Civ. 157 (M.P.) (JA at 119-128).

not established its defense of arson. On April 25, 1973, the Court entered a judgment in favor of Car Color and against Hartford in the amount of $7,354.29 plus interest retroactive to April 3, 1972 (JA at 57). The $7,354.29 figure was the amount the parties initially agreed to as the extent of loss (JA at 131). The April 3, 1972 date was probably the District Court's determination as to the date proof of loss was submitted to Hartford.* The judgment awarded to Car Color did not represent losses solely attributable to its inventory of paints purchased from PPG. The judgment covered all the losses sustained by Car Color as a result of the fire including damages to a wall and to tools (JA at 130-31).

The claim of the United States to a portion of the fund is based upon assessed and unpaid federal withholding taxes due from Car Color as set forth in the following schedule:

Period and Class of Tax	*Date of Assessment*	*Balance*	
3rd Q 1971 Form 941 withholding tax	12/19/71	$1,252.25	(JA at 70)
4th Q 1971 Form 941 withholding tax	3/27/72	825.85	(JA at 71)
		$2,078.10	

Tax liens for the above assessments were filed on May 4, 1972 with the Secretary of State, Albany, New York. The total amount of $2,078.10 plus interest remains due and owing (JA at 58-59).

The competing claim of PPG to the fund is in the amount of $12,300.90 plus interest from April 14, 1972 (JA at 57). The amount of PPG's claim was determined

* Car Color alleged in its complaint that proof of loss was submitted on or about April 6, 1972. (JA at 127).

in an action for goods sold and delivered which was commenced against Car Color on March 3, 1972 in New York County Supreme Court. A default judgment was entered against Car Color on April 14, 1972. PPG served Hartford with an execution in connection with the default judgment on June 26, 1973 (JA at 58).*

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* In addition, PPG served Hartford with a summons of garnishment on February 11, 1972 in Atlanta, Georgia. Since the amount subject to garnishment was dependent uopn Hartford's as yet undetermined liability, PPG and Hartford stipulated to have the case placed on the stipulation docket. No further action was ever taken by PPG with respect to the Georgia garnishment (JA at 57-58).

The chronology and sequence of the events described above is as follows:

EVENT	DATE	AMOUNT	
PPG and Car Color execute security agreement	9/28/70		
PPG files security agreement and financing statement	10/ 8/70	—	
Car Color obtains fire insurance policy with proceeds payable to itself	12/10/70	$25,000	
IRS 3rd Q 1971 assessment	12/10/71	$ 1,252.25	
Fire at Car Color	12/23/71	—	
Georgia garnishment by PPG against Hartford	2/11/72	—	
PPG commences action against Car Color for goods sold and delivered in New York County Supreme Court	3/ 3/72	$12,300.90	
IRS 4th Q 1971 assessment	3/27/72	$ 825.85	
Car Color submits proof of loss to Hartford	4/ 3/72	$ 7,354.29	
PPG secures default judgment in action for goods sold and delivered	4/14/72	$12,300.90	
IRS files tax liens	5/ 4/72	$ 2,078.10	
Earliest date that an action against Hartford could have been brought by Car Color *	6/ 2/72	—	
Car Color judgment against Hartford on insurance policy	4/25/73	$ 7,354.29	plus interest from 4/3/72
PPG served Hartford with an execution in connection with PPG's judgment for goods sold and delivered	6/26/73	$12,300.90	

* A New York insurance company is not liable for an insurance claim until sixty days after proof of loss is submitted. N.Y. Insurance Law § 168(6) (McKinney 1966).

As shown above, the two tax assessments as well as their filing antedate the entry of the $7,354.29 money judgment for Car Color against Hartford on April 25, 1973. Also, the tax assessments and their filings are prior to June 2, 1972, the date when Car Color could have commenced an action against Hartford for breach of the insurance contract. Although PPG's judgment against Car Color for goods sold and delivered occurred prior to the filing of the tax liens, PPG did not execute on the judgment until June 26, 1973, a date more than a year subsequent to the filing of the tax liens.

C. The Basis of the Decision by the Court Below:

Although the Magistrate and the District Court reached the same result as to the distribution of the fund, the paths they took were quite different.

Magistrate Raby found that the default judgment obtained by PPG against Car Color did not have priority over the Government's tax liens because PPG's execution on the judgment was subsequent to the filing of the tax liens on May 4, 1972 (JA at 91). However, the Magistrate found that PPG was an "assignee of the net proceeds of the fire insurance policy" (JA at 92) because of the terms of the security agreement. He concluded that once the fire occurred PPG had a "valid legal right" (JA at 92), prior in time to the Government's liens, to the proceeds of the policy. Magistrate Raby respectfully disagreed with the decision in *Federal Insurance Co.* v. *Billy's Burgers, Inc.*, 72 Civ. 1098 (S.D.N.Y. 1973) (hereinafter *Billy's Burgers*) (JA at 137-147), in reaching his decision. As a consequence, the Government was not to receive any proceeds from the fund.

Judge Conner rejected the Magistrate's finding that upon the occurrence of the fire PPG's purported equitable

assignment of the proceeds of the insurance policy blossomed into a legal right to the proceeds (JA at 108). However, the District Court found that PPG had a Uniform Commercial Code ("UCC") security interest in Car Color's inventory which was transferred to the non-existent insurance proceeds when the property was destroyed by fire (JA at 109). The District Court recognized that the New York UCC did not apply to a claim in or under a policy of insurance (JA at 110). The District Court also recognized that *Billy's Burgers,* although factually indistinguishable, reached the opposite conclusion (JA at 113).

Summary of Argument

It is the Government's position that as a matter of federal law its tax liens had priority over the claim of PPG to the insurance proceeds because the proceeds did not come into existence until after the May 4, 1972 tax lien filing date. Furthermore, under New York law, PPG's claim to the insurance proceeds could not have ripened into a legal lien until the proceeds were in existence and PPG could not have had a UCC security interest in the insurance proceeds at any time. It is respectfully submitted that the decision of the District Court should be reversed to the extent that it granted to PPG a priority over the Government's tax liens.

ARGUMENT

POINT I

A tax lien has priority over a third party's interest in property of a taxpayer which property came into existence subsequent to the filing of the tax lien.

A. The Government Perfected Its Tax Liens Against Car Color:

The Government's tax liens were filed on May 4, 1972. The fund, however, was not created until April 25, 1973, the date of Car Color's judgment against Hartford. The filed liens had their genesis in the two tax assessments which preceded them. On December 10, 1972, the Government made an assessment in the sum of $1,252.25 against Car Color for the unpaid balance of federal withholding taxes. A similar assessment in the amount of $825.85 was made on March 27, 1972.

The federal tax statutes provide that if any person fails to pay any of his federal taxes, a lien for such taxes, plus statutory additions, exists in favor of the Government upon all the taxpayer's property and rights to property. 26 U.S.C. § 6321. Such a lien arises at the time of the tax assessment and continues until satisfied or unenforceable by lapse of time. 26 U.S.C. § 6322.

The federal tax lien attaches not only to property and rights to property belonging to the taxpayer at the time of the assessment, but also to property and rights to property subsequently acquired by the taxpayer. *See, e.g., Glass City Bank* v. *United States*, 326 U.S. 265 (1945); *Texas Oil & Gas Corp.* v. *United States*, 466 F.2d 1040 (5th Cir. 1972), *cert. denied sub nom. Pecos County State Bank* v.

United States, 410 U.S. 929 (1973). Furthermore, a tax lien attaches to a taxpayer's rights to proceeds of a fire insurance policy. *See Aetna Casualty & Surety Co.* v. *Roller*, 69—1 USTC ¶ 9214 (D. Ariz. 1968); *Glens Falls Insurance Co.* v. *Stoetzl*, 1967—1 USTC ¶ 9308 (E.D. Calif. 1966); *Ryman* v. *Spruce Veneer Package Corp.*, 175 F. Supp. 756 (W.D. Wash. 1959); *United States* v. *Spraycar*, 57—1 USTC ¶ 9290 (D.Mont. 1956); *Household Coal & Oil Distributors, Inc.* v. *NEDC, Inc.*, 234 N.Y.S. 2d 6 (N.Y.C. Civil Ct. 1962). In this case, the Government made demands and assessments aggregating $2,078.10 against Car Color. Accordingly, federal liens have attached to the insurance proceeds payable to Car Color by Hartford as the result of Car Color's money judgment against the insurer.

The federal tax statute also provides that a tax lien, once duly filed according to the provisions of 26 U.S.C. § 6323(f), has priority over the claim of competing creditors of the taxpayer unless the claim of the competing creditor meets one of the exceptions set forth in 26 U.S.C. § 6323.

B. The Statutory Exception to the Priority of the Perfected Tax Lien for Holders of a Security Interest Has Not Been Satisfied by PPG:

The statutory exception which PPG relies upon is 26 U.S.C. § 6323(a) which provides:

> "The lien imposed by section 6321 shall not be valid as against any purchaser, mechanic's lienor, or judgment lien creditor until notice thereof which meets the requirements of subsection (f) has been filed by the Secretary or his delegate."

PPG claims that it was the holder of a security interest in the fund prior to May 4, 1972.*

The term "security interest" as used in 26 U.S.C. § 6323(a) is defined in 26 U.S.C. § 6323(h)(1) which reads as follows:

> "The term 'security interest' means any interest in property acquired by contract for the purpose of securing payment or performance of an obligation or indemnifying against loss or liability. A security interest exists at any time (A) if, at such time,

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* No claim has been made that PPG is a judgment lien creditor. PPG did secure a judgment for goods sold and delivered against Car Color prior to the filing of the Government's tax lien. However, the existence of that bare judgment did not confer upon PPG the status of a judgment lien creditor. Car Color obtained judgment against Hartford on the insurance policy on April 25, 1973. PPG did not become a judgment lien creditor until the Sheriff levied on the Hartford judgment on June 26, 1973. *See City of New York* v. *Panzirer,* 23 App. Div. 2d 158, 259 N.Y.S. 2d 284 (1st Dep't 1965); *Ruppert* v. *Community National Bank,* 22 App. Div. 2d 165, 254 N.Y.S. 2d 341 (1st Dep't 1964), *aff'd,* 16 N.Y. 2d 589, 261 N.Y.S. 2d 52, 209 N.E. 2d 100 (1965); *Matter of City of N.Y.*, 75-1 USTC ¶ 9281 (N.Y. Sup. Ct., Bronx County 1975); *County National Bank* v. *Inter-County Farmers Cooperative Ass'n,* 65 Misc. 2d 446, 317 N.Y.S. 2d 790 (Sup. Ct., Sullivan County 1970). Since PPG was not a judgment lien creditor under state law prior to the filing of the tax lien, it does not have priority over the filed tax lien. *See, e.g., Fore* v. *United States,* 339 F.2d 70 (5th Cir. 1964), *cert. denied,* 381 U.S. 912 (1965); *Stuyvesant Insurance Co.* v. *Department of Treasury,* 378 F. Supp. 7 (S.D.N.Y. 1974). The Georgia summons of garnishment was served prior to the filing of the tax lien; however, the Georgia proceeding was never prosecuted by PPG. Indeed, PPG and Hartford stipulated that the proceeding was to be held in abeyance pending determination of Hartford's liability (JA at 66-67). The Georgia proceeding has no significance in establishing lien priorities and should be ignored as irrelevant. *See Walker* v. *Paramount Engineering Co.,* 353 F.2d 445 (6th Cir. 1965); *United States* v. *Erlandson,* 311 F. Supp. 399 (D. Minn. 1969).

the property is in existence and the interest has become protected under local law against a subsequent judgment lien arising out of an unsecured obligation, and (B) to the extent that, at such time, the holder has parted with money or money's worth." 26 U.S.C. § 6323(h)(1) (emphasis added).

The interpretation of this section and the ultimate resolution of the issue of the "existence" of the secured property is a federal question. *See, e.g., Aquilino v. United States,* 363 U.S. 509, 513-14 (1955); *Dugan* v. *Missouri Neon & Plastic Advertising Co.,* 472 F.2d 944, 949 (8th Cir. 1973); *Texas Oil & Gas Corp.* v. *United States, supra,* 466 F.2d at 1049. *See also United States* v. *Mitchell,* 403 U.S. 190, 204 (1971).

The focus of this appeal is on § 6323(h)(1)(A) which provides that the property must be in existence before a security interest can attach and the interest in the property must be protected under local law against a subsequent judgment lien arising out of an unsecured obligation. PPG's interest in the fund fails to satisfy either requirement. Clearly, the fund was not in existence until April 25, 1973—the date of Car Color's judgment against Hartford. As demonstrated in Points II and III, *infra,* PPG's interest was not protected under New York law against the perfected tax lien.

Neither the Magistrate nor the District Court focused on the date of Car Color's acquisition of the right to the proceeds of the insurance policy. In effect, their analysis read "existence" out of the Tax Lien Act. In doing so, the Magistrate and the District Court specifically disagreed with the decision in *Billy's Burgers, supra,* which held that a private third party creditor could not prevail over a tax lien unless the subject property was in actual existence prior to the filing of the tax lien.

In *Billy's Burgers*, the taxpayer entered into an agreement with Kent Store Fixtures, Inc. ("Kent") for the purchase of restaurant equipment (JA at 141). Billy's Burgers became indebted to Kent and the debt was secured by a November 24, 1969 security agreement. A financing statement was duly filed on February 18, 1970. As is the case here, the security agreement provided that Billy's Burgers was to assign to Kent the proceeds of an insurance policy as additional security for the indebtedness. A fire occurred at Billy's Burgers on December 28, 1970. The insurer and Billy's Burgers agreed as to the amount of loss, with proof of loss being filed in July of 1971. Kent advised the insurer of its interest in the fund on February 22, 1971. The Government did not file its tax liens until August 23, 1971 and April 10, 1972—both dates after the agreed proof of loss. The insurance company commenced an interpleader action on February 29, 1972 (JA at 145).

The Court granted the tax lien filed on August 23, 1971 priority over Kent's interest in the insurance proceeds but subordinated the April 10, 1972 tax lien to Kent's claim. Judge Bonsal held:

> "There is no dispute that Kent's security agreement was a perfected security agreement under the Uniform Commercial Code. However, for purposes of § 6323(a) of the Code, a security interest only arises when the subject property is in existence. *Int. Rev. Code of 1954*, § 6323(h)(1). As the insurance proceeds did not become payable until February 29, 1972 when plaintiff instituted this interpleader action . . .. Kent's security interest in the proceeds did not arise till February 29, 1972 . . ." (JA at 144-45).

The analysis of 26 U.S.C. § 6323(h) in *Billy's Burgers* is buttressed by other provisions of section 6323 which, in certain limited situations not applicable here, grant the

holder of an interest in *non-existent* property priority over a filed tax lien. *See* 26 U.S.C. § 6323(c). By so legislating, Congress clearly intended that only a few specified types of property coming into existence after the filing of the tax lien are to be granted priority over a federal tax lien, and that the actual existence of the secured property otherwise be the deciding factor in determining lien priority involving a 26 U.S.C. § 6323(h)(1) security interest.

Section 6323(c) protects property arising under certain commercial financing agreements from tax liens which are filed prior to the existence of the property provided that the holder of the interest is protected under local law against a judgment lien which is acquired after the filing of the tax lien. *Texas Oil & Gas Corp.* v. *United States, supra,* 466 F.2d at 1047-48. The property which is protected by this section must be *"acquired* by the taxpayer before the 46th day after the tax lien filing." 26 U.S.C. § 6323(c)(2)(B) (emphasis added). Thus, a creditor's perfected security interest in the taxpayer's property will not defeat a tax lien unless the taxpayer acquired the secured collateral within 45 days of the filing of the tax lien. *Texas Oil & Gas Corp., supra,* 466 F.2d at 1051.

PPG's claim to the proceeds of Car Color's insurance does not come within the purview of 26 U.S.C. § 6323(c) because an insurance contract is not commercial paper, an account receivable, a mortgage, or inventory. *See* 26 U.S.C. § 6323(c)(2)(C). If PPG's interest did come within the purview of 26 U.S.C. § 6323(c), it, of course, would not be superior to the tax lien of May 4, 1972 because Car Color did not acquire the proceeds until April 25, 1973. Congress could have protected an interest in insurance proceeds had it so chosen. Furthermore, 26 U.S.C. § 6323 (c) and (h)(1) clearly show Congress' emphasis on the actual existence of property in determining the priority issues raised by tax liens.

The legislative history of 26 U.S.C. § 6323(c) and (h)(1) supports the above analysis:

> "[Section 6323(c)] provides that security interests arising under commercial transactions financing agreements . . . entered into before tax lien filing in certain cases are to be protected against Federal tax liens, even though the funds are advanced under the agreement, or the property referred to in the agreement comes into existence, after the tax lien filing.
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> * * * * *
>
> "[P]rotection is afforded only . . . where the inventory, accounts receivable, etc., are acquired before the 45 days have elapsed." Senate Report No. 1708, Federal Tax Lien Act of 1966, 89th Cong., 2d Sess., 1966 U.S. Code Congressional and Administrative News 3722, 3728-29.
>
> * * * * *
>
> "For Federal tax purposes, a security interest is not considered as existing until the conditions set forth here are met even though local law may relate a security interest back to an earlier date and even though it might be an effective security interest as of the earlier date under the Uniform Commercial Code. *Id.* at 3734.

It is clear that Congress did not intend to protect proceeds coming into existence after the filing of a tax lien except as provided in 26 U.S.C. § 6323(c). It is also clear that non-section 6323(c) proceeds must be actually in existence before a holder of an interest in the proceeds can prevail over a tax lien.

Billy's Burgers is entirely consistent with the purpose and intent of 26 U.S.C. § 6323. Insurance proceeds must be in existence before they can qualify as property subject to a security interest under the tax lien law. In the

case at bar, Hartford did not become obligated on the fire insurance policy until the March 25, 1973 judgment—a date subsequent to the Government's tax lien. Moreover, Hartford could not have become liable to pay any funds to Car Color until June 2, 1972, sixty days after proof of loss was submitted by Car Color, which date was also the earliest date when Car Color could have commenced an action against Hartford. *See* N.Y. Insurance Law § 168(6) (McKinney 1966) and page 7 *supra*. This June 2, 1972 date of potential liability was also after the filing of the tax liens. Therefore, as a matter of federal law, PPG did not have priority over the Government's tax liens. *Cf. Texas Oil & Gas Corp.* v. *United States, supra,* 466 F.2d at 1053; *United States* v. *Sterling National Bank & Trust Co.*, 360 F. Supp. 917, 924-25 (S.D.N.Y. 1973), *aff'd & rev'd in part*, 494 F.2d 919 (2d Cir. 1974); *Aetna Casualty & Surety Co.* v. *Roller, supra.*

The same conclusion would result under the traditional "choateness" doctrine.* *Compare Texas Oil & Gas Corp.* v. *United States, supra,* 466 F.2d at 1049-50, *with Nevada Rock & Sand Co.* v. *United States,* 376 F. Supp. 161, 171 (D. Nev. 1974). It is clear that under the choateness doctrine "absolute certainty . . . as to the property subject to [PPG's equitable] lien . . ." was not established until Car Color obtained a judgment against Hartford. Thus, PPG's interest was not entitled to priority over the field tax lien. *United States* v. *Sterling National Bank, supra,* 360 F. Supp. at 924. Likewise, under 26 U.S.C. § 6323,

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* As described in *United States* v. *Sterling National Bank, supra,* 360 F. Supp. at 924:

> "The choateness rule requires that the private lien be perfected in the sense that there is nothing more to be done. This required absolute certainty (1) as to the identity of the lienor, (2) as to the property subject to the lien, and (3) as to the amount of the lien. *United States* v. *City of New Britain,* 347 U.S. 81, 84, 74 S. Ct. 367, 98 L.Ed. 520 (1954)."

PPG's interest in the proceeds does not have priority over the tax lien which was filed before the proceeds came into existence.

POINT II

The New York Uniform Commercial Code does not create a security interest in the proceeds of a Fire Insurance Policy.

A. PPG Had No UCC Security Interest in the Insurance Proceeds:

PPG filed a financing statement and security agreement on August 8, 1970. The financing statement referred the reader to the security agreement for a description of the secured collateral. In addition, the box in the financing statement marked "proceeds" was checked (JA at 63). The Government does not dispute that PPG had a security interest in Car Color's inventory of PPG's paints. The extent of that security interest at the time of the fire, however, was never established. The amount recovered by Car Color in its judgment against Hartford did not establish the value of the paint inventory. The judgment covered all of the loss sustained by Car Color as a result of the fire, including loss to the paint inventory, Car Color's tools, and a wall. (JA at 130). PPG claims that the judgment against Hartford represents proceeds which were covered by the filing of the financing statement and security agreement. Although the security agreement did provide that Car Color would assign the proceeds of fire insurance to PPG, which assignment never occurred, that agreement must, nevertheless, be viewed in light of New York law as to its effect.

Assuming *arguendo* that the proceeds were in existence as required by 26 U.S.C. § 6323, PPG would also have to demonstrate that pursuant to 26 U.S.C. § 6323(h)(1)(A)

the proceeds were protected under New York law against a subsequent judgment lien arising out of an unsecured obligation. *See United States* v. *Pioneer American Insurance Co.*, 374 U.S. 84, 89 (1963); *Walker* v. *Paramount Engineering Co., supra*, 353 F.2d at 449. The District Court held that upon the happening of the fire, PPG had a perfected UCC security interest (JA at 109). This holding is in clear conflict with New York law.

Two provisions of New Y[illegible]'s Uniform Commerc[illegible] Code are relevant here: §§ 9-104 a[illegible] 9-306. N.Y.U.C.C. §[illegible]04, 306 (McKinney 1964). Section 9-104 should end the discussion. *See Aetna Casualty & Surety Co.* v. *Roller, supra* (a tax lien case). It provides:

> "This Article does not apply
>
> * * * * *
>
> (g) to a transfer of an interest or claim in or under any policy of insurance. . . ."

Thus, the filing of the security agreement as it related to insurance proceeds could have no effect. The District Court held, however, that UCC § 9-306 created a security interest in the fire insurance proceeds. Although no New York court has ruled on the issue of whether fire insurance interests are "proceeds" under UCC § 9-306, other courts have dealt with the issue and have held UCC § 9-306 inapplicable. *See In re Levine*, 6 UCC Reporting Service 238 (Bankruptcy Ct., D. Conn. 1969); *Quigley* v. *Caron*, 247 A.2d 94 (Me. 1968); *Universal C.I.T. Credit Corp.* v. *Prudential Investment Corp.*, 222 A.2d 571 (R.I. 1966). *Cf. In the Matter of Law Research Service, Inc.* v. *Martin Lutz Appellate Printers, Inc.*, 498 F.2d 836, 837 n.2 (2d Cir. 1974), where this Court recognized the binding effect of another exclusion in UCC § 9-104.*

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* The recent decision of Chief Judge Mischler in *Firemen's Fund American Insurance Co.* v. *Ken-Lori Knits, Inc.*, — F.

[Footnote continued on following page]

B. The Rationale of the District Court Was Clearly Erroneous:

The District Court, nevertheless, held that the interests under the insurance policy were proceeds as defined by New York's UCC. The rationale of the District Court was two-fold. One, the District Court held that New York courts would, in effect, ignore N.Y. UCC § 9-104(g) and instead find that a proposed amendment to UCC § 9-306 by the American Law Institute and the National Conference of Commissioners on Uniform States Laws would be judicially promulgated as the law of the State of New York. *See* American Law Institute and National Conference of Commissioners on Uniform State Laws, *1972 Official Text and Comments of Article 9 Secured Transactions and Conforming Amendments to Related Sections with Supplementary Text Showing Additions and Deletions and Statements of Reasons for Changes Made* § 9-306 (Dec. 17, 1971) (hereinafter "1972 Official Text"). Two, the District Court held that the case of *Andrello* v. *Nationwide Mutual Fire Insurance Co.*, 29 App. Div. 2d 489, 289 N.Y.S. 2d 293 (4th Dep't 1968) (hereinafter "*Andrello*"), would be extremely persuasive on the issue of PPG's priority over the Government's tax lien "particularly since it effectuated, in a reasonable manner, the clear intent of the parties." (JA at 115). It is respectfully submitted that neither basis for the District Court's opinion withstands scrutiny.

Supp. — (E.D.N.Y., May 8, 1975) (73 C 1242) is not to the contrary. In *Firemen's Fund*, the Court held that fire insurance proceeds were UCC § 9-306(1) proceeds. However, the premise of the Court's holding was that the creditor was named as a loss-payee in the debtor's fire insurance policy. PPG chose not to avail itself of loss-payee status. Had PPG been a loss payee prior to May 4, 1972, Car Color would not have had a property interest in the insurance proceeds that could have been attached by a tax lien. *See In re Swan-Finch Oil Corp.*, 279 F. Supp. 386 (S.D.N.Y. 1967); *Fields* v. *Western Millers Mutual Fire Insurance Co.*, 290 N.Y. 209, 48 N.E. 2d 489 (1943); *National Factors, Inc.* v. *Holford*, 27 App. Div. 2d 377, 279 N.Y.S. 2d 470 (1st Dep't 1967).

The District Court focused on a proposed amendment to UCC § 9-306. The proposed amendment and the necessary parallel amendment to UCC § 9-104(g) have not, in any respect, been adopted by the legislature of the State of New York.* The amendments would define protected proceeds to include "[i]nsurance payable by reason of loss or damage to the collateral . . . ." *Compare* N.Y.U.C.C. §§ 9-104(g), 306(1) (McKinney 1964), with 1972 Official Text §§9-104(g), 306(1), reprinted in R. Anderson, *Uniform Commercial Code* 1097, 1202 (Cumulative Supplement 1974).**

Under New York law, an interest in an insurance contract is simply not protected. The 1972 Official Text proposed to change the New York language to encompass interests in insurance and insurance proceeds. The purpose of the amendment was to "overrule various cases to the effect that proceeds of insurance on collateral are not proceeds of the collateral." 1972 Official Text, reprinted in R. Anderson, *Uniform Commercial Code* 1204 (Cumulative Supplement 1974).

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* The 1972 Official Text has only been adopted by ten states: Arkansas, effective January 1, 1974; Illinois, effective July 1, 1973; Iowa, effective January 1, 1975; New Jersey, effective July 1, 1975; North Dakota, effective January 1, 1974; Oregon, effective January 1, 1974; Texas, effective January 1, 1974; Virginia, effective July 1, 1974; West Virginia, effective July 1, 1975; Wisconsin, effective July 1, 1974. *See* Current Materials, UCC Reporting Service, at State Correlation.

** Since the Car Color judgment against Hartford did not represent insurance payable solely by reason of damage to Car Color's PPG inventory, this condition has not been met. *A fortiorari*, the insurance proceeds are not identifiable to the PPG inventory and consequently would not be protected. *See* 1972 Official Text § 9-306(3)(b), reprinted in R. Anderson, *Uniform Commercial Code* 1203 (Cumulative Supplement 1974). *See Morrison Steel Co.* v. *Gurtman*, 113 N.J. Super. 474, 274 A.2d 306 (App. Div. 1971).

The District Court also held that *Andrello* justified the conclusion that PPG's interest in the insurance proceeds was a "security interest" as defined by 26 U.S.C. § 6323. This reliance was misplaced.

In *Andrello,* the taxpayer purchased fire insurance on real property he owned which was encumbered. The policy, as is the case here, did not contain a loss payee clause in favor of the creditor. On August 11, 1964, the insured premises was destroyed by fire. At that time, the property was subject to a mortgage which included the statutory language contained in N. Y. Real Property Law § 254(4) (McKinney 1968), which does not differ in substance from the Car Color-PPG security agreement as it pertains to insurance. In accordance with § 254(4), the taxpayer assigned the insurance policy to the mortgagees on August 12, 1974. 29 App. Div. 2d at 491, 289 N.Y.S. 2d at 295. Subsequently, the insurer commenced an interpleader action and the insurer was discharged from liability upon the payment of $8,500 into court. Although the Government made assessments in 1964 and 1965, the outcome of *Andrello* was controlled by the fact, conceded by the Government, that liens were never properly filed. 29 App. Div. 2d at 493, 289 N.Y.S. 2d at 297. Thus, there was no real issue of lien priority presented in *Andrello.* In the instant case, the Government's liens were properly filed.

The *Andrello* court analyzed the mortgagee's interest in the insurance policy and held that "[*f*]*ollowing the fire* [the mortgagees] . . . had an equitable lien upon the moneys due under the policy even in the absence therein of a provision making loss payable to them." 29 App. Div. 2d at 493, 289 N.Y.S. 2d at 297 (emphasis added). The equitable lien did not attach until the time of fire. Since the Government never properly filed its tax liens, the equitable lien became perfected upon the creation of the fund and there were no intervening tax liens which would abrogate the mortgagee's interest.

Andrello involved realty. It did not involve, in any respect, the Uniform Commercial Code which is applicable to secured personalty. Consequently, *Andrello* does not lend any support to the District Court's decision. To the extent that *Andrello* is apposite, it establishes that PPG merely had an equitable interest in the proceeds of the insurance policy at the time of the fire.

POINT III

An equitable lien in the proceeds of an insurance policy does not take priority over a subsequent tax lien which is filed before the insurance proceeds come into existence.

New York law provides that when a person agrees to assign rights to property not yet in existence, an equitable lien will be created in favor of the assignee and enforceable by him. *See Speelman* v. *Pascal,* 10 N.Y.2d 313, 222 N.Y.S. 2d 324, 178 N.E.2d 723 (1961). Where a debtor obtains insurance payable to himself, but for the benefit of a creditor, the creditor likewise has an equitable lien in the insurance proceeds. *Cromwell* v. *Brooklyn Fire Insurance Co.,* 44 N.Y. 42 (1870); *Nor-Shire Associates, Inc.* v. *Commercial Union Insurance Co.,* 25 App. Div. 2d 868, 270 N.Y.S. 2d 38 (2d Dep't 1966); *Rath* v. *Aerovias Interamericanas de Panama*, 205 Misc. 135, 127 N.Y.S. 2d 231 (Sup. Ct., N.Y. County 1953). However, when a third party obtains a *legal* lien against the assignor's rights to the property subsequent to the creation of the equitable lien, the intervening legal lienor takes priority over the equitable lienor. *Harold Moorstein & Co.* v. *Excelsior Insurance Co.,* 25 N.Y. 2d 651, 306 N.Y.S. 2d 464, 254 N.E. 2d 766 (1969), *aff'g* 31 App. Div. 2d 177, 296 N.Y.S. 2d 2 (1st Dep't 1968); *Stathos* v. *Murphy,* 26 App. Div. 2d 500, 276 N.Y.S. 2d 727 (1st Dep't 1966), *aff'd,* 19 N.Y. 2d 883, 281 N.Y.S. 2d 81, 227 N.E. 2d 880 (1967). A federal tax lien, once duly filed, constitutes

a legal lien against all of the existing and after acquired property of the taxpayer. Consequently, the tax liens here have priority over PPG's equitable lien. *Texas Oil & Gas Corp.* v. *United States, supra*, 466 F.2d at 1052-53; *United States* v. *Trigg*, 465 F.2d 1264, 1269 (8th Cir. 1972), *cert. denied sub nom. First State Bank* v. *United States*, 410 U.S. 909 (1973); *In re Rosenberg's Will*, 62 Misc. 2d 12, 15, 308 N.Y.S. 2d 51, 57 (Surrogate's Ct., Kings County 1970). The sole remaining question is whether PPG's equitable lien became a legal lien prior to May 4, 1972, the date the Government's tax liens were filed. As *Andrello* held, the equitable lien did not exist until the date of the fire, December 23, 1971. In the interim, PPG's equitable lien did not become a legal lien.

In *Harold Moorstein & Co.* v. *Excelsior Insurance Co., supra*, the New York Court of Appeals spoke clearly on this issue. The Court stated:

> "[W]e note that the dictum in the opinion below, interpreting *Stathos* v. *Murphy* (26 AD 2d 500, aff'd. 19 N Y 2d 883) to give the assignee of proceeds of a claim priority over attaching lienors, is *clearly incorrect*. As was pointed out in the opinion in *Stathos* (at pp. 503-504), the assignment of after-acquired proceeds of a claim is generally considered an assignment only of a future right and, therefore, the assignment does not give the assignee priority over lienors who have attached before the proceeds have come into existence." 25 N.Y. 2d at 653, 306 N.Y.S. 2d at 465, 254 N.E. 2d at 767 (emphasis added).

The factual context of the criticized lower court's opinion is similar to the case at bar.

The taxpayer in *Harold Moorstein & Co.* sustained a fire loss and thereafter assigned 50% of its claim for the loss

to a third-party. After the assignment, the taxpayer initiated a lawsuit against its insurer which was settled. Prior to the settlement, the Government filed tax liens. The settlement fund was sufficient to satisfy the claims of the assignee and the Government. Therefore, no priority issue was presented. Nevertheless, the lower court held that the assignee would have been given priority over the tax lien had the issue been presented. The New York Court of Appeals' categorization of the lower court's dictum as "clearly incorrect" would be also applicable to a finding that the interest of PPG became a legal lien prior to the filing of the tax lien.

This Court has recently addressed itself to the equitable lien law of New York. In *In the Matter of Law Research Service, Inc.* v. *Martin Lutz Appellate Printers, Inc., supra*, a bankruptcy case which involved the assignment of an existing judgment, the Court stated:

> "Under New York law . . ., the assignment of an existing right creates an immediate lien in favor of the assignee that is valid against later lien creditors of the assignor. . . . The assignment of a future right, on the other hand, creates a lien that attaches only at such time as the right accrues. *See, e.g., Okin* v. *Isaac Goldman Co.,* 79 F.2d 317, 319 (2d Cir. 1935)." 498 F.2d at 837-38.

The word "accrues" in the above quotation poses a possible conflict with the New York Court of Appeals language in *Harold Moorstein & Co.* It is clear from the opinion of the New York Court of Appeals that the actual existence of a fund rather than the accrual of the assignor's right is the telling factor in determining lien priority. It is also clear that the authority cited for this Court's position focused on the existence of a fund and not on the accrual of a right to a fund. *See Okin* v. *Isaac Goldman Co.,* 79 F.2d 317, 319 (2d Cir. 1935) ("[A]n agreement that payment shall be made out of a fund when it comes into exis-

tence creates an equitable lien valid against a trustee in bankruptcy . . .").

In any event, even though the Court awarded interest retroactive to April 3, 1972, in the Car Color case, Car Color's action could not have accrued, as a matter of law, until June 2, 1972. PPG's interest in the insurance proceeds was of an equitable nature only. The equitable lien could not have become a legal lien until March 25, 1973. Because this date is subsequent to the filing date of the Government's tax liens, the tax liens have priority.

CONCLUSION

The judgment of the District Court should be reversed to the extent it subordinated the Government's tax liens to the interest of PPG in the fund.

Respectfully submitted,

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ted States Attorney for the Southern District of New York.

That on the 2nd day of
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